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SUBJECT: JAPAN -- 2009 DRAFT NATIONAL TRADE ESTIMATES REPORT

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**¶11.** (U) Per reftel instructions, the following is the Post's draft chapter on Japan for the 2008 National Trade Estimate Report. We understand Washington agencies will update the trade and investment data in the first three paragraphs of the report as they have done in the past. Embassy Econ Section is also emailing the text of the draft report to USTR, in MS Word format and showing changes from last year's version.

**¶12.** (SBU) Begin text of the draft 2009 National Trade Estimate:

#### TRADE SUMMARY

The U.S. goods trade deficit with Japan was \$82.8 billion in 2007, a decrease of \$5.8 billion from \$88.6 billion in 2006. U.S. goods exports in 2007 were \$62.7 billion, up 5.1 percent from the previous year. Corresponding U.S. imports from Japan were \$145.5 billion, down 1.8 percent. Japan is currently the fourth largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Japan were \$41.3 billion in 2006 (latest data available), and U.S. imports were \$23.9 billion. Sales of services in Japan by majority U.S. owned affiliates were \$53.5 billion in 2005 (latest data available), while sales of services in the United States by majority Japan owned firms were \$28.4 billion.

The stock of U.S. foreign direct investment (FDI) in Japan was \$91.8 billion in 2006 (latest data available), up from \$79.3 billion in **¶2005**. U.S. FDI in Japan is concentrated largely in the finance, manufacturing, wholesale trade, and the professional, scientific, and technical services sectors.

#### REGULATORY REFORM OVERVIEW

The United States-Japan Regulatory Reform and Competition Policy Initiative

Through the United States-Japan Regulatory Reform and Competition Policy Initiative (Regulatory Reform Initiative), the U.S. Government seeks changes to regulations and practices in Japan that limit competition, prevent development of innovative products and services, and hinder access for U.S. products and services to Japan's market. The U.S. Government addresses a wide range of issues through this Regulatory Reform Initiative in specific industry sectors including information technologies, telecommunications, and pharmaceuticals/medical devices, as well as in other areas that affect multiple sectors such as competition policy and insufficient transparency in government rule-making.

The governments of the United States and Japan concluded the

Regulatory Reform Initiative's seventh annual Report to the Leaders in June 2008, which documented progress made under the Regulatory Reform Initiative since late 2007. Continuing work under the Initiative, the U.S. Government presented further, detailed recommendations to Japan in October 2008. After several months of working- and high-level talks, the next Report documenting progress is expected to be completed in the summer of 2009.

The following sections on Sectoral Regulatory Reform and Structural Regulatory Reform outline some of the key reform and market access issues that the U.S. Government continues to seek progress on by Japan under this Regulatory Reform Initiative.

## SECTORAL REGULATORY REFORM

### Telecommunications

In its 2008 recommendations to Japan under the Regulatory Reform Initiative, the U.S. Government continued to urge that Japan ensure fair market opportunities for emerging technologies and business models, develop a regulatory framework for converged and Internet-enabled services, and strengthen competitive safeguards on dominant carriers. The U.S. Government also continues to request that Japan improve transparency in rulemaking and ensure the impartiality of its regulatory decision making, including by abolishing the legal requirement that the government own one-third of the dominant carrier, Nippon Telegraph and Telephone (NTT).

**Interconnection:** Japanese laws and regulations do not prevent NTT's regional carriers from imposing high rates and onerous conditions on their competitors for interconnection. Japan's Ministry of Internal Affairs and Communications (MIC) made further revisions to its Rules

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for Interconnection Charges, resulting in modest reductions in interconnection rates, which fell another 3.4 percent in April 2008.

On NTT's fiber optic infrastructure, which is not regulated like traditional infrastructure, NTT introduced interconnection rates that are high by international standards and almost four times those applied to traffic on other fixed-line networks regulated by MIC. Moreover, NTT's fiber optic infrastructure is not regulated in a manner transparent to consumers. The U.S. Government looks to MIC to ensure reasonable interconnection terms and conditions and competitive rates are established, particularly as NTT continues deployment of its Internet Protocol (IP) based Next Generation Network replacing the analog network that all carriers currently use to reach subscribers in Japan.

**Dominant Carrier Regulation:** NTT continues to dominate overwhelmingly Japan's fixed line market. Japan sought to promote competition in the telecommunications market through its Competition Promotion Program. However, as Japan's broadband users turn from digital subscriber line (DSL) to optical fiber, NTT's competitors fear NTT might expand its dominant position through control of the fiber-to-the-home (FTTH) market and by bundling NTT fixed services with those of NTT DoCoMo, the dominant wireless operator. In October 2007, MIC issued a revised "New Competition Promotion Program 2010" in an effort to address competition concerns as suppliers increasingly offer telecommunications services over IP based networks. The U.S. Government has urged Japan to speed the plan's implementation and will continue to monitor MIC's implementation of the program.

**Universal Service Program:** Japan approved a system, beginning in January 2007, for NTT East and West and its competitors to collect a seven yen per month universal service fee from voice services subscribers. Based on a periodic review, MIC approved a 25 percent increase in the fee, from six to eight yen per month per number, effective January 2009. NTT regional carriers (the only carriers able to benefit from the fund) then receive these fees through the universal service fund to offset the costs of providing services in rural areas. The U.S. Government has urged Japan to broaden the base of this fund's potential beneficiaries and ensure it is implemented in a competitively neutral manner. Cross-subsidization of NTT West by NTT East using interconnection revenue (ostensibly to address NTT West's higher network costs resulting from the higher

number of rural subscribers) further undercuts arguments for the program's need.

**Mobile Termination:** Like most countries, Japan uses the "Calling Party Pays" system, imposing the entire cost of termination on the calling party (enabling mobile subscribers to benefit from free incoming calls). Although NTT DoCoMo, the dominant mobile incumbent carrier, has lowered its termination rates over the past 10 years, rates remain high. Despite recognizing DoCoMo as a dominant carrier in 2002, MIC does not require DoCoMo to explain how its rates are calculated. With new entrants now in the mobile sector, the U.S. Government will closely monitor actions both by DoCoMo and MIC to address such rates to ensure the possibility of effective competition.

**New Mobile Wireless Licenses:** Starting in 2005, MIC began opening the market to new mobile providers beyond the three main incumbents by auctioning blocks of spectrum to a limited number of new wireless entrants. In December 2007, MIC awarded two additional licenses for wireless broadband services. However, the complexity of factors MIC chose in determining how to evaluate applications raises questions about whether it achieved its stated goal of awarding these licenses based on objective criteria. Given the scarcity of spectrum and high demand for new technologies, the U.S. Government has urged MIC to consider alternative means, including auctions, to assign commercial spectrum in a timely, transparent, objective, and nondiscriminatory manner that adheres to principles of technology neutrality. The U.S. Government has also stressed to Japan the importance of ensuring reasonable "roaming" rates for competitors and Mobile Virtual Network Operators (MVNOs), an issue where MIC is making noticeable progress through policies and dispute mediation, as evidenced by an increase in service offerings launched by new entrants in 2007.

#### Information Technologies (IT)

Through its October 2008 Regulatory Reform Initiative recommendations, the U.S. Government continues to urge that Japan ensures its regulatory framework for IT and electronic commerce promotes competition and innovation, enhances transparency, and protects users, in addition to taking new steps to protect intellectual property rights (IPR) in the face of challenges posed by globalization and new technologies in a digital era.

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**IT and Electronic Commerce Policymaking:** To augment measures Japan has taken to promote and support the use of IT and electronic commerce, the U.S. Government has urged Japan to take steps to ensure transparent policy and rule-making processes are applied in order to provide interested parties with opportunities to express their views and to be aware of and participate in the work of related government-appointed advisory groups; implement laws, regulations, and guidelines to promote choice and competitive market conditions by ensuring technology providers and users have the flexibility to choose preferred technologies; work cooperatively with the private sector on international standards development and, when appropriate, use established international standards in formulating IT and electronic commerce guidelines and regulations; and ensure its IT and electronic commerce policies and laws are compatible with international practices.

**Privacy:** With Japan's Law on the Protection of Personal Information (Privacy Law) entry into effect in April 2005, Japan's ministries and agencies formulated implementation guidelines to ensure its effectiveness. The Cabinet Office reviewed the Privacy Law's implementation and released a report in June 2007. The U.S. Government stressed that clear, consistent, and predictable privacy guidelines should be developed across ministries, with separate guideline provisions added as necessary for individual business sectors, and that any recommendations regarding cross-border transfers provide effective protection for individuals' personal information without unduly restricting the international flow of data.

**IPR Protection:** The U.S. Government continued to urge Japan to

adopt a number of new measures to strengthen IPR protection. These measures include extending the term of copyright for sound recording and all other subject matter protected under Japan's Copyright Law; adopting a statutory damages system that would deter infringing activities; improving the efficacy of the patent application process; and actively working with the United States to develop ways to promote greater protection of IPR worldwide, especially in Asia. (See also "Intellectual Property Rights Protection" in this chapter.)

**Government IT Procurement:** In order to increase the transparency and fairness of Japan's IT procurements and to stimulate innovation and competition in those procurement activities, the U.S. Government has urged Japan to ensure all procuring entities comply with Japan's Basic Policy for the Public Procurement of Computer Systems; improve communications with suppliers interested in the implementation of Japan's government IT procurement policy; apply a new Japanese system, comparable to the U.S. Bayh-Dole system to allow companies to control the intellectual property of inventions they develop under government contracts to all government procurement; allow IT vendors to limit their liability to a level proportionate to the risks they take in government procurement transactions; reduce the use of sole source contracting in IT procurements, including by applying rules on competitive bidding to independent administrative legal entities, government-sponsored private companies, and local governments; and ensure contracts are swiftly concluded after winning bidders are chosen and are not backdated.

#### Medical Devices and Pharmaceuticals

The U.S. Government continues to urge Japan to reform its reimbursement pricing and regulatory systems for pharmaceuticals and medical devices in order to foster industry's development of innovative products and to improve the access of patients in Japan to such products. The Ministry of Health, Labor and Welfare (MHLW), in its 2007-2008 "Vision" policy paper, called for eliminating lag times for drug and device approvals, developing an internationally competitive industry, and making Japan an attractive investment destination. The U.S. Government supports Japan's goal of ending the device and drug lags by increasing the number of reviewers to expedite product approvals and by reforming the pricing system to improve incentives for research and development of advanced medical products.

Japan is the largest foreign market for U.S. medical devices and pharmaceuticals. The U.S. Government, in its 2008 Regulatory Reform Initiative recommendations, urged Japan to take measures to improve its regulatory system in order to eliminate the lag in the introduction in Japan of innovative pharmaceuticals and medical devices. The U.S. Government urged Japan to foster simultaneous global drug development, cut drug approval times by reforming review and clinical-trial consultation systems, and to improve vaccine reviews. The U.S. Government urged Japan to reduce device approval times by, *inter alia*, setting and attaining performance goals and hiring more reviewers, expediting approvals of minor changes in devices, and streamlining IVD approvals. The U.S. Government expects Japan's new goals of improving its regulatory system will prove effective, including plans to cut drug approval times by 2.5

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years by 2012; more than double the drug review staff by 2010; and to increase the device review staff by 30 percent by 2009. In its April 1, 2008 biennial price revision, Japan adopted reimbursement pricing policies that are inconsistent with the Government of Japan's goal of rewarding innovation and developing an internationally competitive drug and device industry. Those 2008 policies include broadening the repricing rule based on market expansion to cover a wider range of drugs, regardless of whether the drugs experienced increased market share. The U.S. Government continues to urge Japan to abolish repricing based on market expansion because the rule reduces incentives for introducing innovative medicines in Japan. Japan also adopted policies that imposed a stricter application of the "Foreign Average Price" (FAP) rule for medical devices, even though the rule has already significantly reduced the price of devices in Japan. The U.S. continues strongly urging Japan to refrain from implementing reimbursement pricing policies that hinder development and introduction of innovative medical devices and pharmaceuticals.

Such Japanese policies not only discourage companies from efficiently introducing advanced medical products to the Japanese market, a particular concern due to Japan's aging population, but also harm the competitiveness of the industry and serve as a disincentive to investment in research and development. In its 2008 price revision, MHLW continued to adhere to the use of biennial, instead of annual, reimbursement rate reviews. The U.S. Government continues strongly urging Japan to avoid any reimbursement changes that undermine the introduction of innovative products.

In an effort to improve its drug reimbursement policies, MHLW in the 2008 Report to the Leaders noted it has agreed to provide opportunities for industry to comment on recommendations for pharmaceutical pricing reform, and for industry to make proposals to improve economic returns for patented drugs. With regard to reimbursement for medical devices, MHLW adopted measures in its 2008 price revision to reward innovative medical technologies. These measures include revising reimbursement price adjustment premiums, shortening the reimbursement listing procedure for category (C1) medical devices, and properly evaluating advanced diagnostic imaging equipment and techniques.

Japan's 2002 Blood Law established a principle of "self-sufficiency" and includes a Supply and Demand Plan for the government to manage the blood market. The U.S. Government continues to urge Japan to not restrict imports of plasma protein products so as to increase patient access to life-saving blood plasma therapies. In particular, the U.S. Government urges Japan to allow labeling of blood products to reflect country of origin rather than a "voluntary" or "non-voluntary" designation, and to increase the efficiency of product reviews. The U.S. Government also urges Japan to develop a separate reimbursement pricing system for blood products that accounts for the unique nature of plasma protein therapy characteristics (Japan currently maintains a single reimbursement system for both drugs and blood products).

**Nutritional Supplements:** Japan has taken steps to streamline import procedures and to open its \$10 billion nutritional supplements market. However, many market access barriers remain. Unusual restrictions on health and nutrition claims are a major concern. Japan classifies nutritional supplements as food. Only those products approved as Foods for Specific Health Uses (FOSHU) or Foods with Nutritional Function Claims (FNFC) are allowed to have health or structure/function claims. However, producers are unable to obtain FOSHU or FNFC approval for most nutritional supplements due to FOSHU's costly and time consuming approval process and the limited range of vitamins and minerals that qualify for FNFC. Other concerns include excessively long lead times for food additive applications; high levels of import duties for nutritional supplements compared to duties on pharmaceuticals containing the same ingredient(s); stopping of shipments at quarantine stations due to naturally occurring traces of substances such as benzoic acid and sorbic acid, which Japan classifies as food additives; and the potential for opaque development of health food safety regulations.

**Cosmetics and Quasi-Drugs:** Japan is the world's second-largest market for cosmetics after the United States, yet regulatory barriers continue to limit consumer access to safe and innovative products. Unlike the U.S. over the counter drug monograph system, Japan requires premarket approval for products such as medicated cosmetics that are classified as quasi-drugs under the Pharmaceutical Affairs Law. The approval process includes requirements that are burdensome, lack transparency, and do not appear to enhance product safety, quality or efficacy. In addition, many types of advertising claims for cosmetics and quasi-drugs are prohibited, even if scientifically verifiable, denying consumers relevant and important information to help them make sound choices. Other concerns related to cosmetics and quasi-drugs include burdensome paperwork and long lead times for the approval of imported products. The U.S. Government continues to recommend Japan

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address these and other issues under the Regulatory Reform Initiative.

Financial Services

The Japanese government has stated repeatedly its goal of improving

the international competitiveness of Japan's financial sector. In December 2007, the Financial Services Agency (FSA) unveiled its "Plan for Strengthening the Competitiveness of Japan's Financial and Capital Markets," and submitted amendments to the Financial Instruments and Exchange Law (FIEL) in March 2008. The 2006 FIEL amended 89 financial laws and consolidated the remainder into a cohesive text. The FIEL sought to enhance investor protection and promote the movement of financial assets into securities markets through cross-sectoral rules for investment product sales, management, and disclosure. However, given the hundreds of pages of statutes comprising the FIEL and that implementation of the law began September 30, 2007, the FIEL's overall effect is still not discernable. Partners are looking to see that FIEL implementing regulations, interpretation, and enforcement are evident, consistent, and predictable. As part of its principles-based supervisory initiative, FSA announced a new code of conduct for financial institutions April 18, 2008 after a series of consultations with business associations.

Japan has improved the transparency and predictability of the financial regulatory system, but further progress is needed. In particular, FSA could expand the body of written interpretations of Japan's financial laws. While FSA has enhanced supervision and disclosure, it must continue to move forward to establish transparency in regulation and supervision of financial institutions to bring them in line with international standards and best practices in order to help realize the government's goal of improving Japan's global competitiveness as a financial services center.

**No-Action Letters and Written Interpretations:** The FSA has made some efforts to enhance the effectiveness of Japan's no-action letter system, including by soliciting input from U.S. and other foreign firms on how best to improve the system. Use of the system, however, has not materially increased. The U.S. Government continues to recommend FSA explore ways to expand use of the no-action letter system. The U.S. Government has also encouraged FSA to expand the written interpretations it provides, including through greater use of its "interpretive letter" system and increasing the number of "reference cases" published on the FSA Internet site.

#### Agriculture

Japan maintains many tariff and nontariff barriers against trade in the agricultural sector. The U.S. Government's October 2008 submission to Japan under the Regulatory Reform Initiative includes several recommendations to enhance the efficiency of the trading environment for agricultural products and the transparency of trade-related rules and regulations. These include implementing a Maximum Residue Limits (MRL) regime that ensures any mitigating measures are the least trade restrictive possible; providing national treatment to imports and that are in accordance with international practices; allowing additional substances in organic crop production and modifying current pesticide residue policy to enhance organic trade; completing the review of widely used food additives that are recognized as safe by the Joint FAO/WHO Evaluation Committee on Food Additives; implementing a plant quarantine system that harmonizes the classification of plant pests and diseases based on the International Plant Protection Convention standards for official control and risk analysis; and following international standards for the treatment of post-harvest fungicides. The United States also continues to call on Japan to apply science-based standards in accordance with World Organization for Animal Health (OIE) protocols on the trade in beef. (See also Standards, Testing, Labeling, and Certification in this chapter.)

**Plant Quarantine Issues:** Japan maintains a restrictive plant quarantine system, which includes measures that are not always based on science. A key impediment to trade is Japan's frequent use of nationwide bans on imported products in response to narrowly focused quarantines imposed by exporting countries in their home markets. Japan's practice runs counter to recognized international standards, which support targeted, regional bans (e.g., states or counties) limited to affected geographic areas. For example, when a disease or pest outbreak is reported in a contained area of the United States, Japan tends to ban imports of all associated U.S. plant products regardless of their region of origin. Such steps are

unnecessarily trade restrictive. Through the Regulatory Reform Initiative, the U.S. Government continues to urge Japan to use pest

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risk analysis that is based on international standards, and to provide a scientific justification for its responses and to clearly articulate how adopted quarantine measures accurately reflect the level of phytosanitary protection Japan has determined to be appropriate.

Japan's Ministry of Agriculture, Forestry, and Fisheries (MAFF) prohibits the entry of various fresh plant products due to the presence of pests, even though some of these pests are also present in Japan. Japan has a pest forecast system that monitors certain domestic pests and alerts producers to potential increased pest damage. For decades, the Japanese government has contended this system constitutes official control under the International Plant Protection Convention (IPPC), the international standard setting body for plant protection. According to the Japanese government, it must impose a similar system for imported commodities. Japan more recently took initial steps to harmonize with international standards. In December 2004, Japan notified the WTO of its intent to relax quarantine measures for several plant pests and diseases. In May 2006, five additional cosmopolitan pests were added to the list of pests subject to relaxed quarantine measures. Although the U.S. Government welcomes these actions, Japan continues to impose measures related to many other pests that are more restrictive than those provided for in international standards and adversely affect U.S. exporters.

#### STRUCTURAL REGULATORY REFORM

##### Antimonopoly Law and Competition Policy

Although Japan has made significant positive steps in recent years to bolster its competition regime, cartel activity and bid rigging persist with deleterious effects for the country's economy and government finances. Additional measures to combat anticompetitive behavior would improve the business environment. Further attention must also be given to ensuring antimonopoly enforcement procedures are perceived to be fair and transparent.

**Establishing More Effective Deterrence to Anticompetitive Behavior:** The Antimonopoly Act (AMA), Japan's primary competition legislation, provides for both administrative and criminal sanctions against violators. However, criminal prosecutions, which would more effectively deter anticompetitive behavior, have been few. From 1990 through October 2007, the Japan Fair Trade Committee (JFTC) initiated 12 criminal prosecutions of alleged AMA violators. While Japanese courts have imposed substantial financial penalties on companies and prison sentences on individuals convicted of violating the AMA, they have consistently suspended prison sentences on individuals, even in the case of repeat offenders. The U.S. Government continues to urge Japan to take steps to maximize the effectiveness of enforcement against hard-core violations of the AMA, including by increasing the number of criminal prosecutions, strengthening criminal sentences of convicted individuals, and maintaining a system that imposes both administrative surcharges and criminal sanctions on corporate participants in cartel and bid rigging conspiracies.

The JFTC's ability to enforce the AMA effectively is also hindered by the lack of sufficient personnel. JFTC staff totaled 765, including 409 assigned to the Investigation Bureau, as of March 31, 2008, with an additional 30 additional staff anticipated by March 2009. The JFTC remains relatively weak, however, in the number of employees with post-graduate economics training, a factor that undermines JFTC ability to engage in the careful economic analysis necessary to properly evaluate non-cartel behavior. The U.S. Government continues to urge the JFTC to improve its economic analysis capabilities.

**Improving Fairness and Transparency of JFTC Procedures:** The JFTC introduced a system in January 2006 to allow companies subject to a proposed cease-and-desist or surcharge payment order to review the evidence relied upon by JFTC staff and to submit evidence and make

arguments in their defense prior to an order being issued. The JFTC implemented a similar system for proposed recipients of public warnings for suspected violations of the AMA or the Premiums and Misrepresentations Act. To ensure further the credibility and transparency of JFTC hearing procedures, however, the U.S. Government has asked the Japanese government to lengthen significantly the two week period during which a company may respond to a draft cease-and-desist or surcharge order from the JFTC; increase the number of JFTC hearing examiners who are outside legal professionals; and strengthen conflict of interest rules with respect to hearing examiners. The U.S. Government has also requested clarification of conditions under which the JFTC might return to an ex-ante hearing system, improved regulations for the standards and procedures used by the JFTC to issue warnings, and

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recognition of attorney-client privilege in JFTC investigation and hearing procedures.

**Broadening Measures to Combat Bid Rigging:** Japanese authorities have implemented a series of measures to address the problem of frequent and persistent bid rigging. Apart from several cases of invocation by the JFTC of the 2003 law against bureaucrat-led bid rigging (so-called *kansei dango*), the Ministry of Land, Infrastructure, Transport and Tourism (MLIT) has strengthened administrative sanctions against companies found by JFTC to have engaged in unlawful bid rigging. MLIT also introduced an administrative leniency program to complement the JFTC leniency program (designed to help encourage individuals and companies to report anticompetitive acts) and put in place a series of measures aimed at ensuring a competitive bidding process for project contracts tendered by the Ministry. In June 2007, the Japanese Diet passed new legislation aimed at controlling post-retirement employment by Japanese government officials in companies they previously helped regulate or were otherwise involved with while in government service, the so-called "descent from Heaven" (*amakudari*), which has been a factor in many bid rigging conspiracies. The U.S. Government has recommended that Japan increase the standard minimum period of suspension from bidding for companies involved in bid rigging conspiracies; work to prevent conflicts of interest in government procurement; strengthen efforts to eliminate involvement in bid rigging by government officials; and expand the existing administrative leniency programs.

#### Transparency

Transparency issues continue to be a top concern of U.S. companies that operate in the Japanese market. The U.S. Government has strongly urged Japan to adopt a number of new measures to achieve a higher degree of transparency in governmental regulatory and policy making processes -- a critical ingredient necessary to further improve the business and trade environment.

**Advisory Groups:** Although advisory councils and other government commissioned study groups are accorded a significant role in the development of regulations and policies in Japan, the process of forming these councils and study groups often remains opaque and nonmembers are not uniformly offered meaningful opportunities to provide input into these groups' decision-making processes. The U.S. Government continues to urge Japan to ensure transparency of advisory councils and other government sponsored working groups through new requirements, including those that will ensure ample and meaningful opportunities are provided for all interested parties, as appropriate, to participate in and directly provide input to these councils.

**Public Comment Procedures (PCP):** U.S. companies are frustrated by the inadequate degree to which Japanese ministries and agencies implement public comment procedures. In particular, concern remains that comment periods are unnecessarily short and comments provided are not adequately taken into consideration before final decisions are made. The U.S. Government has stressed the need for Japan to ensure its PCP all being fully implemented and to make additional revisions to the system so that truly meaningful opportunities are made available for public input into policy-making and regulatory processes. In addition, the U.S. Government continues to encourage

Japan's ministries and agencies to accelerate the voluntary practice of providing greater opportunities for the public to comment on legislation in the early stages of its formation.

**Transparency in Regulation and Regulatory Enforcement:** To ensure the private sector has sufficient information about regulations, including interpretations of those regulations, and the information necessary to comply, the U.S. Government has requested Japan specifically require its ministries and agencies to make public their regulations and any statements of policy of generally applicable interpretation of those regulations.

#### Privatization

The Japanese government's effort to privatize the Japan Post Group has made important progress. The U.S. Government recognizes that reform in this area, if implemented in a fully market-oriented manner, can have an important positive effect on the Japanese economy by stimulating competition and leading to a more productive use of resources.

The U.S. Government welcomes the ongoing privatization of Japan Post, which has multi-billion dollar banking and insurance businesses in addition to its mail and parcel delivery operations. The U.S. Government monitors carefully the implementation of the Japanese Government's reform efforts, and continues to call on the

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Japanese Government to ensure all necessary measures are taken to achieve a level playing field between the Japan Post companies and private sector participants in Japan's banking, insurance, and express delivery markets.

In the area of express carrier services, the U.S. Government remains concerned by unequal conditions of competition between Japan Post Service and U.S. international express delivery providers. The U.S. Government is strongly urging Japan to enhance fair and equal competition, including by ensuring Japan Post Service is subject to similar customs clearance procedures and costs for international express delivery services and that subsidization of Japan Post Service's international express service by revenue from noncompetitive postal services is prevented.

The U.S. Government also has continued to urge the Japanese government to ensure that the process by which this reform proceeds is made fully transparent, including by full and meaningful use of Public Comment Procedures and through opportunities for interested parties to express views to related officials and advisory bodies before decisions are made. The U.S. Government is additionally asking Japan to ensure the triennial review of postal privatization is open and addresses the equivalence of competition in the banking, insurance, and express delivery sectors. (For detailed discussion of Japan Post privatization and the postal insurance corporation, see "Insurance" under the Services Barriers section.)

#### Commercial Law

Japan undertook a major reform of its commercial law by enacting a new Corporate Code, which entered into force May 1, 2006. Among other provisions, the code permits the use of modern merger techniques, including domestic and cross-border triangular mergers. After significant public controversy, however, the Japanese government in April 2007 finalized tax and public disclosure rules for cross border triangular mergers that substantially limit the use of these techniques. Under the new rules, in order for shareholders to defer capital gains on the transaction, the foreign acquiring company, at a minimum, must establish a subsidiary with an office, an employee/executive, and some "business activity" in the Japanese market before the merger. As of December 2007, only one transaction has taken place using these provisions.

Through the Regulatory Reform Initiative, the U.S. Government continues to urge Japan to improve further its commercial law and corporate governance systems to reflect international best practices, promote efficient corporate restructuring and increases in shareholder value. Specifically, the U.S. Government is urging Japan to review impediments to the use of modern merger techniques

now available to investors, including whether tax rules unduly impede the ability of foreign investors to use triangular merger mechanisms.

The U.S. Government also continues to encourage Japan to strengthen further corporate governance mechanisms, including by facilitating and encouraging active proxy voting by institutional investors such as pension and mutual funds; requiring authorization of antitakeover measures by a company committee composed of a majority of truly independent directors; ensuring sufficient protection of minority shareholders in management buy-out and take-over bid situations; and encouraging the major Japanese stock exchanges to adopt listing rules or guidelines that encourage best corporate governance practices.

Article 821 of the new Company Law still has the potential to create burdens for foreign corporations that conduct their primary business in Japan through Japanese branch offices. The U.S. Government has recommended that Japan adopt a simple re-domestication procedure that allows foreign companies to merge or convert into a Japanese corporation, and continues to request that Japan amend Article 821 to prevent adverse effects on the legitimate operation of foreign companies in Japan.

#### Legal System Reform

Japan imposes restrictions on the ability of foreign lawyers to provide international legal services in Japan in an efficient manner. The U.S. Government is urging Japan to further liberalize the legal services market by allowing foreign lawyers to form professional corporations and establish multiple branch offices in Japan whether or not they have established a professional corporation, and by counting all of the time foreign lawyers spend practicing law in Japan toward the 3 year experience requirement for licensure as a foreign legal consultant. The U.S. Government has also requested that Japanese lawyers may become members of international legal partnerships with lawyers outside Japan without restriction. Japan has agreed to continue to examine these issues,

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including by holding further hearings with both the Japanese Bar Association and registered foreign lawyers practicing in Japan. The U.S. Government is urging Japan to promote arbitration and other alternative dispute resolution (ADR) procedures, including by amending the Foreign Lawyers Law to explicitly permit foreign lawyers to act as neutrals and to represent parties in any international ADR proceedings taking place in Japan.

#### Distribution and Customs Clearance

The U.S. Government welcomes Japan's efforts to formulate an Authorized Economic Operator (AEO) system in Japan, which allows exporters with good compliance records to process goods more expeditiously through Customs. However, Japan Customs currently does not allow post-mortem declarations, and requires brokers to declare express items at specific Customs offices, which limits flexibility and potentially increases processing costs. To further facilitate trade, the U.S. Government continues urging Japan under the Regulatory Reform Initiative to allow customs brokers to make post-mortem declarations for items valued at less than 250,000 yen (about \$2,500), and for those brokers using the Japan Customs' Nippon Automated Cargo Clearance System (NACCS) automated database to declare express items at any Customs office.

To facilitate more efficient cargo flows, the United States recommends Japan exempt AEO exporters from paying the five percent consumption tax for cleared cargo. Currently, Japan Customs refunds this tax, but exemption would reduce the administrative burden of filing for a refund.

In line with international best practice to reduce workloads and maximize efficiency, the U.S. Government also recommends Japan raise the Customs Law de minimis ceiling from 10,000 yen (about \$100) to at least 20,000 yen or higher.

#### IMPORT POLICIES

**Rice Import System:** Japan's highly regulated and nontransparent importation and distribution system for imported rice limits meaningful access to Japanese consumers. In 1999, Japan established a tariff-rate quota (TRQ) of approximately 682,000 metric tons (milled basis) for imported rice. The Japan Food Department (JFD) of the Ministry of Agriculture, Forestry, and Fisheries (MAFF) manages imports of rice within the TRQ through periodic minimum access (MMA) tenders and through the simultaneous buy-sell (SBS) tenders. Imports of U.S. rice under the MMA tenders are destined almost exclusively for government stocks. MAFF releases these stocks solely for non-table rice users in the industrial food processing or feed sector, and for re-export as food aid.

Japan failed to fulfill its import obligation for rice in Japan Fiscal Year 2007, which ran from April 1, 2007 to March 31, 2008. The unique conditions in 2007 that led to higher global rice prices exposed several weaknesses in Japan's administration of its MMA trade quota system for rice. Japan subsequently committed to implementing several improvements to prevent future non-fulfillment of the MMA rice TRQ system, including earlier and more frequent tenders.

U.S. rice exports to Japan in calendar year 2007 were valued at \$206 million, representing approximately 322,000 metric tons of rice or 52.4 percent of Japan's minimum access requirement (on a JFY07 basis). However, only a small fraction of rice imported from the United States reaches Japanese consumers identified as U.S. rice, despite industry research showing Japanese consumers would buy U.S. high-quality rice if it were more readily available.

Excessive testing requirements for rice imports have hampered trade in U.S. rice to Japan. In December 2005, MAFF began imposing strict testing requirements on rice imports, ostensibly to ensure compliance with the Japanese Government's new Maximum Residue Limits policy. Rice and wheat, however, are the only commodities for which Japan requires multiple testing, including a separate test by the rice industry. This testing has resulted in a disproportionate increase in the cost of bringing U.S. rice to market, particularly for SBS rice because of its smaller import lot size.

**Wheat Import System:** Japan requires wheat to be imported through MAFF's Food Department, which then resells wheat to Japanese flour millers at prices substantially above import prices. These high prices discourage wheat consumption by increasing the cost of wheat-based foods in Japan. In 2007, MAFF revised the wheat import regime to allow more frequent modification to the resale price based on international price movements. As a result, the resale price to flour millers has increased 55 percent. The U.S. Government remains concerned by Japan's operation of a state trading entity for wheat

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and its potential to distort trade. For example, MAFF suspended tenders for wheat imports in September 2008 due to concerns over MAFF's own contracting and management of imports.

**Pork Import Regime:** Japan is the world's largest importer of pork, and also the number one export market for U.S. pork -- \$1.4 billion in 2007. Japan's pork import system includes a gate price and a safeguard negotiated during the Uruguay Round, which automatically raises the gate price if imports are 119 percent or more of the average level of imports relative to a corresponding period that covers the previous 3 years. The U.S. Government continues to raise concerns that Japan's complicated "gate price" system distorts trade and is vulnerable to invoice fraud.

**Beef Safeguard:** Japan negotiated a beef safeguard during the Uruguay Round to protect domestic producers in the event of an import surge. The safeguard is triggered when imports increase by more than 17 percent from the previous Japanese fiscal year on a cumulative quarterly basis. Once triggered, the safeguard remains in place for the rest of the fiscal year. If triggered, beef tariffs will rise to 50 percent from 38.5 percent. The U.S. Government is seeking a change in the beef safeguard in the Doha Development Agenda negotiations. The U.S. Government remains concerned that once Japan fully opens its market to U.S. beef and

beef products, the resulting increase in imports might trigger Japan's safeguards, which could hamper the U.S. beef producers' ability to regain historical export levels in the near future (see the section on "Beef" under the "Standards" heading for context).

**Fish Products:** Japan has been the most important export market for U.S. fish and seafood products for over 30 years; as recently as 1988, 73 percent of U.S. seafood exports went to Japan. In 2006, however, the European Union surpassed Japan as the most important export market for fisheries products, with only 23 percent of U.S. seafood exports going to Japan. These data should be viewed, however, against the growing trend of U.S. origin seafood being routed through China and Korea for value added processing and/or cold storage holding before being imported into Japan, making actual trade flows harder to follow.

Tariffs on Japanese seafood imports are generally low, but market access is not seamless for some products. Japan maintains several species and product-specific import quotas on fish products, including pollock, surimi, pollack and cod roe, herring, Pacific cod, mackerel, Pacific whiting, squid, and sardines. Administration of the system has improved considerably over the years and it is expected that obstacles to Japanese importers and processors will continue to be reduced. While Japan cut tariffs as a result of the Uruguay Round, it did not change its import quotas. As part of ongoing WTO Doha negotiations, Members including the United States and Japan have committed to clarify and improve rules on fisheries subsidies.

**High Tariffs on Beef, Citrus, Dairy, and Processed Food Products:** Japan maintains high tariffs on a number of food products that are important exports for the United States, including red meat, citrus, wine, and a variety of processed foods. Examples of double digit import tariffs include 38.5 percent on beef, 32 percent on oranges, 40 percent on processed cheese, 29.8 percent on natural cheese, 17 percent on apples, and a 15 to 29.8 percent on wine depending on the HTS classification. These high tariffs generally apply to food products where Japan is protecting domestic producers. Tariff reductions are a high priority for the U.S. Government in the Doha Development Agenda agriculture negotiations.

**Wood Products and Building Materials:** Japan continues to restrict imports of certain manufactured wood products through tariff escalation (i.e., progressively higher tariffs based on the level of processing of the wood product). The elimination of tariffs on wood products remains a long standing U.S. Government objective.

**Leather/Footwear:** Japan continues to apply a TRQ on leather footwear that substantially limits imports into Japan's market, and establishes these quotas in a nontransparent manner. The U.S. Government continues to seek elimination of these quotas.

#### STANDARDS, TESTING, LABELING, AND CERTIFICATION

Japan's enforcement of national standards hinders trade in certain farm, forest, and industrial products. U.S. industry has raised concerns that Japan's stringent testing methods and low tolerances for regulated substances such as pesticides and food additives make it difficult to satisfy import requirements for many products. The U.S. Government is urging Japan to use science based standards and implement risk-based enforcement policies, which are the least trade restrictive measures that also satisfy consumer safety concerns.

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#### Standards

**Beef:** On July 27, 2006, Japan partially reopened its market to U.S. beef. Except for approximately one month from December 2005 to January 2006, Japan's market had been effectively closed since the December 2003 detection of a cow with Bovine Spongiform Encephalopathy (BSE) in Washington State.

Japan allows imports of U.S. beef and beef products from animals aged 20 months or younger. However, this limited reopening has prevented the United States from regaining all but a small portion

of its historic level of exports to the Japanese market. Before the ban, Japan was the largest export market for U.S. beef and beef products, totaling roughly \$1.4 billion annually.

The U.S. Government has repeatedly urged Japan to bring its BSE measures in line with international guidelines set by the World Organization for Animal Health (OIE) by allowing imports of all U.S. beef and beef products derived from animals of all ages deemed safe under OIE guidelines. In May 2007, the OIE determined that the United States is a "Controlled Risk" country for BSE, a determination based on science. The U.S. Government remains highly concerned by Japan's unwillingness to adopt science-based, international guidelines under which beef and beef products can be safely traded and will continue to work vigorously bilaterally and multilaterally toward achieving a full reopening of Japan's market to U.S. beef in line with OIE guidelines.

**Enforcement of Maximum Residue Limits (MRLs):** In May 2006, Japan's Ministry of Health, Labor, and Welfare (MHLW) implemented a new system of regulations governing agrochemical residues in food. Under this system, foods containing residues in excess of established MRL levels will not be allowed on the Japanese market. Prior to implementation of this positive list, the U.S. Government worked closely with MHLW to address potentially trade restrictive measures. However, several outstanding issues remain, including Japan's MRL enforcement policy. For example, a single MRL violation may result in MHLW placing sanctions on the entire industry rather than on just the company with the violation. In the case of multiple violations, MHLW can implement an "inspection order," i.e., 100 percent test-and-hold requirements. The possible delays due to this sanction can lead to major losses for perishable goods. These sanctions can severely affect trade regardless of the level of the violation or the degree of the threat to health. Furthermore, domestic violations may be treated more favorably than import violations. To address these concerns, the U.S. Government is urging MHLW, through the Regulatory Reform Initiative, to implement a regime that is as minimally trade restrictive as possible, provides national treatment to imports, and accords with international best practices.

**Restrictive Food Additive List:** Japan's list of food additives restricts imports of several U.S. food products, especially processed foods. The list, which limits the use of specific food additives on a product-by-product basis, is more restrictive than accepted international standards and is without sufficient scientific evidence. For example, the list effectively prohibits imports of light mayonnaise, creamy mustard or figs containing potassium sorbate, a food additive evaluated and accepted by numerous national and international standard setting organizations, including the Joint FAO/WHO Expert Committee on Food Additives. Despite this prohibition on imports, Japan allows the use of potassium sorbate in 36 other foods, most of which are traditional Japanese food products not normally produced outside Japan.

U.S. manufacturers have complained about the slow and opaque approval process for indirect food additives (i.e., additives that do not remain on food, such as solvents).

In 2002, Japan created a list of 46 food additives for expedited review. The U.S. Government and many of Japan's other trading partners have been disappointed by the lack of progress by the MHLW and the Food Safety Commission in finalizing reviews and approving many of these additives, notwithstanding the availability of extensive safety data. In addition, Japan classifies post-harvest fungicides as food additives requiring registration and approval, while the international community, including Codex, classifies them as pesticides. As a result, a chemical that is approved for use as a pesticide under Japan's system would be prohibited from post-harvest use unless it has also been approved as a food additive. The U.S. Government has urged Japan through the Regulatory Reform Initiative to complete an expedited review of the remaining food additives.

**Microbial Content Standards:** Japan's standards under the Food

Sanitation Law for microbial content on frozen foods are, in certain instances, impractical and overly restrictive, particularly for foods that require cooking before consumption.

**Poultry:** Since 2002, Japan has imposed several national and statewide bans on the import of U.S. poultry, poultry-meat, and eggs due to the detection of notifiable avian influenza (NAI) in U.S. poultry, both high pathogenic notifiable avian influenza (HPNAI) and low pathogenic notifiable avian influenza (LPNAI). These bans are not consistent with international guidelines and have disrupted millions of dollars of U.S. poultry trade. According to international guidelines recently revised by the OIE, countries must report to the OIE any findings of NAI in domestic poultry, regardless of its pathogenicity. These guidelines, as well as the WTO SPS agreement, provide for importing countries to impose bans on imports only from affected regions (zones) of the exporting country.

While the guidelines support banning certain poultry meat from regions affected by HPNAI, they do not support banning poultry meat from regions affected by LPNAI. As a result of bans based on the reporting of high and low pathogenic avian influenza, as well as other factors, U.S. poultry meat exports to Japan have decreased substantially, from roughly \$148 million in 2001 to \$29 million in 2007.

**Organics:** U.S. organic exports to Japan continue to be limited by Japan's ban on alkali extracted humic acid, a production substance that is allowed for use on U.S. organic crops. In addition, Japan's zero tolerance policy for pesticide residues on organic products is not consistent with international standards, and is, in practice, more thoroughly enforced for imported organic products.

**Marine Craft:** Although Japan continues to maintain an inspection regime for new boats and marine engines that is unique in the world in its severity and complexity, Japan's regulatory agencies, MLIT and the Japan Craft Inspection (JCI) Organization, have made a significant shift towards adoption and acceptance of ISO standards, when these ISO standards are determined to provide equivalent or improved safety. The U.S. Government looks to accelerate progress with Japan as quickly as possible to also address Japanese requirements that no other country considers necessary, such as requiring that each imported boat be individually inspected. These unusual rules place an enormous burden on Japanese importers and American boat manufacturers. The U.S. Government will continue to work with relevant organizations and agencies in Japan to urge Japan's acceptance of acceptance of third-party tests of Japanese ISO based standards.

#### Building Size, Designs, and Wood Products

Japan has adopted and implemented regulations with respect to indoor air quality and chemical emissions, and may be considering additional steps. The U.S. Government will continue to monitor regulatory developments in this area and urge that Japan ensures transparency in any resulting rule making process. In addition, Japan's fire testing of wood frame assemblies also is subject to standards that are open to interpretation by testing facilities, thereby affecting predictability in meeting Japan's fire testing requirements.

#### Biotechnology

Japan is the world's largest per capita importer of bioengineered grains and annually imports about 516 million metric tons of U.S. corn and 3.3 million metric tons of U.S. soybeans. In 2007, exports of these commodities alone were worth \$3.7 billion. To both secure bilateral trade in grains and to increase global food security, the United States and Japan share a common interest in promoting effective biotechnology approval and regulatory policies.

Japan's regulatory system, however, is complex and compliance is costly. Japan's independent Food Safety Commission conducts risk assessments in support of product evaluations by the Ministry of Health, Labor and Welfare and Ministry of Agriculture, Forestry and Fisheries. The regulatory burden is such that only large multinational companies or governments can afford to complete the approval process, even for bioengineered traits that are relatively well known. Furthermore, the continued growth in the number and complexity of new biotechnology applications in coming years could

strain the regulatory system. There is also the real possibility of trade disruptions from an unapproved bioengineered variety showing up in trace amounts in imported grain or processed foods. To avoid disrupting trade, the U.S. Government is working with Japan's regulatory agencies to encourage a risk based, case-by-case approach when dealing with unapproved varieties.

In addition to Japan's national regulatory system, 12 prefectural

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and local governments maintain rules, generally not based on science, which further limit cultivation of bioengineered crops. These rules, combined with local regulations and public pressure on research institutions, have made it increasingly difficult for technology companies to secure sites for field trials, mandated under the national government's approval process.

Although Japan is the largest per capita importer of bioengineered crops, no consumer-ready foods with recognizable bioengineered ingredients are sold in Japan. One factor that keeps bioengineered foods out of the supermarket is Japan's labeling requirement. As yet, no Japanese food manufacturer or retailer has been willing to test the market for a genetically modified organism labeled, consumer-ready food.

The U.S. Government will continue to encourage Japan to address these issues and continue to participate in discussions on biotechnology policy advancement and regulation in international fora (i.e., the WTO, the Codex Alimentarius Commission, the OECD, and the APEC forum) and through international agreements dealing with international movement of bioengineered crops.

#### Labeling

**Proprietary Ingredient Information Disclosure Requirement for Import:** As part of its product classification process for new-to-market food and dietary supplement products, Japan mandates that all ingredients and food additives be listed by name, along with content percentages, and include a description of the manufacturing process. In addition to being overly burdensome, this process runs the risk that proprietary information may be obtained by competitors.

**Labeling of Beef:** In 2007, the Ministry of Agriculture, Forestry, and Fisheries adopted labeling guidelines for "wagyu" beef. Although presented as voluntary standards, the guidelines bar use of the term "wagyu" on cattle not born and raised in Japan. The U.S. Government is concerned by the regulation and is monitoring this situation closely.

#### GOVERNMENT PROCUREMENT

Japan is a Signatory to the WTO Agreement on Government Procurement (GPA). For procurement of construction services by sub-central and government enterprises covered under the GPA, Japan applies a threshold of approximately \$22 million, which is three times the threshold applied by the United States.

#### Construction, Architecture, and Engineering

Even though Japan has the second largest public works market in the world (\$149 billion in 2007), U.S. companies annually obtain far less than 1 percent of projects awarded. Two bilateral public works agreements are in effect: the 1988 United States-Japan Major Projects Arrangements (MPA) (updated in 1991); and the 1994 United States-Japan Public Works Agreement, which includes the Action Plan on Reform of the Bidding and Contracting Procedures for Public Works (Action Plan). The MPA included a list of 42 projects in which international participation is encouraged. Under the Action Plan, Japan must use open and competitive procedures for procurements valued at or above the thresholds established in the GPA. Public works issues are raised in the Expert-Level Meeting on Public Works under the United States-Japan Trade Forum.

Problematic practices continue to limit the participation of U.S. design/consulting and construction firms in Japan's public works

sector, including bid rigging (dango), under which companies consult and prearrange a bid winner. The prevalence of dango is evidenced by the recent Defense Facility Agency procurement, in which 58 major construction companies were implicated in dango. The U.S. Government continues to stress the need for Japan to effectively address this pervasive problem.

Another concern is Japan's use of excessively narrow Japan-specific qualification and evaluation criteria that preclude U.S. firms from competing for projects. The U.S. Government has asked Japan to develop procedures to simplify the qualification process for foreign firms that have relevant experience outside of Japan, as well as to ensure that all project-related qualification requirements are made public, as required by the GPA and the bilateral agreements. Other concerns with Japan's procurement practices include the imposition of unreasonable restrictions on the formation of joint ventures, extremely low design fees, and excessive and costly documentation requirements for design bids.

The U.S. Government has urged Japan to increase the use of

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Construction Management and Project Management in its public works to create greater opportunities for U.S. firms, which have extensive expertise in these areas. Construction and Project Management involve advanced project delivery and management systems that maximize project efficiency.

The U.S. Government is paying special attention to several major projects covered by the public works agreements of particular interest to U.S. companies with the expectation that they will provide important opportunities for U.S. firms. These projects include the Okinawa Institute of Science and Technology; Haneda Airport development and expansion; Kansai International Airport; Central Japan International Airport; Kyushu University Relocation Project; Gaikan Expressway Project; Metropolitan Expressway Shinagawa Route Projects; Japan Post's Post Office Projects; major public buildings, large-scale hospital building projects, urban development and redevelopment projects; major PFI projects; and the MPA projects still to be undertaken or completed.

#### INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

The U.S. Government continues to pursue its IPR protection agenda with Japan through bilateral consultations and cooperation, as well as in multilateral and regional fora. For its part, Japan continues to make progress in improving the protection of IPR. In addition to increasing our bilateral cooperation, the U.S. Government has identified several areas in Japan's IPR protection regime where further action by Japan is needed.

##### Patents

The U.S. Government continues to urge Japan to adopt a 12-month patent application filing grace period, similar to that provided under U.S. law, to harmonize the two systems and enhance U.S. innovators' protection against a possible loss of patent rights in Japan. The U.S. Government also continues to urge Japan to implement procedures to avoid a piecemeal approach to patent examinations that results in unnecessarily lengthy delays in granting patents.

In 2005, Japan established an Intellectual Property High Court staffed with judges and judicial research officials conversant with IPR cases, which the Japanese government reports has reduced the average length of litigation. The U.S. Government welcomes this reduction in the average length of litigation and will continue to monitor the implementation and effect of Japan's reforms on the cost, length, and effectiveness of IPR-related litigation.

##### Copyrights

Adequate protection of intellectual property, including copyrights and neighboring rights, is critical for the continued development and competitiveness of content-related industries such as entertainment software, music, film, literary works, and software,

and is a vital component to advancing electronic commerce and a well-functioning digital economy. The U.S. Government remains concerned that Japan's Internet service provider liability law does not provide adequate protection for the works of right holders on the Internet or the appropriate and necessary balance of interests among telecommunications carriers, service providers, rights holders, and website owners. The law could be improved by including a requirement for more expeditious notification to right holders in the "notice and takedown" system.

The U.S. Government continues to monitor Japan's efforts to promote digital content distribution and urges that Japan work to preserve and support the international framework governing the exclusive rights of authorship and the incentives to create in order to keep pace with advances in distribution-related technologies.

The U.S. Government is also urging Japan to continue efforts to reduce piracy rates, including piracy on the Internet, and has recommended Japan amend its Civil Procedures Act to provide for the availability of statutory damages for infringement, at the election of the right holder, as an alternative to actual damages. Police and prosecutors should be given ex officio authority to enable them to investigate and prosecute IPR crimes on their own initiative, without the requirement of right holder consent. To develop Japan's digital communication networks, Japan's Copyright Law should better protect the technological adjuncts to copyright protection such as strengthening the remedies for trafficking in the tools used to circumvent access controls. Japan also does not forbid copyright infringement in government operations through a public decree or the issuance of regulations.

The U.S. Government is also concerned about the scope of the

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personal use exception, both as it applies to the Internet and to book piracy in the educational context, and is encouraging Japan to make clear in its law that the otherwise infringing use of copyrighted works over peer-to-peer networks is not excused by the personal use exemption; and to address loopholes in Japan's personal use exception that appears to allow copies of entire textbooks to be made.

The U.S. Government also continues strongly urging Japan to extend the term of protection for all the subject matter of copyright and neighboring rights to life plus 70 years, or where the term of protection of a work (including a photographic work), performance, or phonogram is calculated on a basis other than the life of a natural person, to 95 years.

Japan's government is coordinating an ongoing discussion among stakeholders of these and other related issues and plans to revise Japanese laws in the near term. The U.S. Government welcomes this process and encourages Japan to ensure it is open, inclusive, and transparent, and offers all stakeholders fair opportunities to express views.

#### Border Enforcement

Border enforcement is a critical component of effective IPR protection. The U.S. Government notes steps taken by Japan to strengthen its own border enforcement as well as to provide assistance to improve the border enforcement of key trading partners. The U.S. Government also welcomes revisions to the Customs Tariff Law, which went into force in 2007, including expanding the list of prohibited goods for export to include items that infringe copyrights and neighboring rights, and strengthening the penalty clauses for customs offences. It is important for Japan to continue its aggressive interdiction of infringing articles and to vigorously apply new provisions of the Customs Tariff Law. The U.S. Government also welcomes Japan's international efforts to enhance IPR enforcement in fora such as the G-8, APEC, and the WTO TRIPS Council, as well as in the ad hoc Japan-China-Korea trilateral Customs dialogue.

#### SERVICES BARRIERS

## Insurance

Japan's private insurance market is the second-largest in the world, after that of the United States, with direct net premiums of an estimated 35.8 trillion yen (over \$300 billion) in Japan fiscal year (FY) 2007. In addition to the offerings of Japanese and foreign private insurers, substantial amounts of insurance are also provided to Japanese consumers by a web of insurance cooperatives (kyosai), and the Kampo life insurance company (a wholly government-owned entity of the Japan Post Group). Given the size and importance of Japan's private insurance market as well as the scope of the obstacles that remain, the U.S. Government continues to place a high priority on ensuring that the Japanese government's regulatory framework fosters an open and competitive insurance market.

**Kampo Insurance:** The Japan Post Group's insurance business, Kampo, continues to be the largest player in Japan's insurance market. At the end of Japan's FY 2007, there were approximately 62 million life and annuities insurance policies issued by Kampo in force compared to 127 million issued by all private life insurance companies combined. (Note: only 651,000 of those policies were issued by the "new" Kampo after the commencement of privatization on October 1, 2007; the rest are now assets of the Successor Corporation created as part of the privatization transition.) The U.S. Government has long standing concerns about Kampo's impact on competition in Japan's insurance market. It remains vital that Japan create a level playing field between Kampo and private sector insurers to cultivate competition, encourage more efficient allocation of resources, and stimulate economic growth.

The U.S. Government is closely monitoring the privatization of Japan Post and implementation of related reforms. The Japan Post reform framework established by Japan's Diet in 2005 includes a number of key measures that, if implemented fully, will represent long awaited progress in areas of concern to U.S. and insurers in the market. Importantly, the legislation also included establishment of equivalent conditions of competition between the Japan Post companies and the private sector as a basic principle of the reforms.

In addition to ensuring equal supervisory treatment between Kampo and private sector companies, the U.S. Government continues to seek that Japan take the steps necessary to achieve a level playing field. Among those steps, the U.S. Government urges that adequate

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measures are implemented to ensure that cross-subsidization does not take place among the newly created Japan Post businesses and related entities, including by ensuring the Japan Post companies' strict compliance with the Insurance Business Law's arms-length rule and requiring adequate financial disclosures to demonstrate that cross-subsidization is in fact not occurring. The U.S. Government also continues to emphasize the importance of ensuring the company established to manage Japan's post office network will transparently and without discrimination select insurance products of private providers for distribution throughout the network.

The U.S. Government continues to call on Japan to ensure a level playing field between the postal insurance company and private insurers. Approval of new products by the new postal insurance company has shifted to a process whereby decisions are made by the Prime Minister (with the Commissioner of the Financial Services Agency acting as proxy) and Minister of Internal Affairs and Communications, after hearing the opinion of an appointed government advisory body. This process should be transparent and open to all parties. It is also critical that the process include careful analysis of, and full consideration given to, actual competitive conditions in the market and that private sector views are actively solicited and considered before decisions are made.

As modifications to the postal financial system could have serious ramifications to competition in Japan's insurance market, adequate transparency in implementation of the reforms passed by the Diet is essential. The U.S. Government has urged Japan to continue to take a variety of steps that ensure transparency, including providing meaningful opportunities for interested parties to exchange views

with related government officials as well as members of government-commissioned advisory committees and groups before decisions, including those on new products, are made; and fully utilizing public comment procedures with respect to drafting and implementing regulations, guidelines, Cabinet Orders, and other measures.

**Kyosai:** Insurance businesses run by cooperatives, or kyosai, hold a substantial market share of insurance business in Japan. Some kyosai are regulated by their respective agencies of jurisdiction (the Ministry of Agriculture, Forestry and Fisheries, or the Ministry of Health, Labor and Welfare, for example) instead of by the FSA, while others have been allowed to operate without any regulatory supervision at all. These separate regulatory schemes undermine the ability of the Japanese government to provide companies and policyholders a sound, transparent, regulatory environment, and afford kyosai critical business, regulatory, and tax advantages over their private sector competitors. The U.S. Government believes all kyosai must be subject to the same regulatory standards and oversight as their private sector counterparts to ensure a level playing field and to protect consumers.

The Japanese government took some important steps in 2006 to bring more oversight scrutiny to unregulated kyosai. Under these regulatory reforms, previously unregulated kyosai were required by April 2008 to apply to the FSA for new legal status. Some of the cooperatives, which elected to become full-fledged insurance companies, have been held to the same regulatory standards as private sector insurers. Others opted to become "Small Amount Short Term Insurance Providers," which limits their product range and size and holds the firms to different requirements than those applied to private sector insurance companies. The remaining unregulated kyosai are expected to wind down their business in 2009.

With respect to kyosai regulated by ministries and agencies other than the FSA, the U.S. Government remains concerned by their continued expansion in Japan's insurance market and continues to call on Japan to bring these kyosai under FSA supervision.

**Policyholder Protection Corporations:** The Life and Non-life Policyholder Protection Corporations (PPCs) are mandatory policyholder protection systems created in 1998 to provide capital and management support to insolvent insurers. Japan's Diet passed legislation in 2005 to renew the PPC system and is preparing to renew the legislation prior to April 2009. While some improvements have been made, the PPC system continues to rely on pre-funding by its members, instead of adopting a system of funding to follow an insolvency that results in a draw of funds from the PPC (post-funding). The U.S. Government continues to urge Japan to adopt more fundamental changes in the PPC systems, including the post-funding approach.

**Bank Sales:** The Japanese government decided in December 2007 to liberalize fully the range of products eligible to be sold through the bank sales channel. As a follow-up to that change, the United States asked Japan promptly to conduct a review of market conduct rules, including the limits on sales of first and third sector

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products and treatment of customer data (including Insurance Business Law Enforcement Rules, Article 212), to ensure they do not limit the bank sales channel's effectiveness or impede consumer convenience.

#### Professional Services

U.S. and other foreign firms and individuals are hampered in providing professional services in Japan by a complex network of legal, regulatory, and commercial practice barriers. U.S. professional services providers are highly competitive. Their services also help facilitate access for U.S. exporters of other services and goods, and contribute valuable expertise to the economies they serve. The availability of such services can be a key factor in U.S. firms' decisions whether to invest and thus is central to improving the environment for foreign direct investment in Japan.

**Accounting and Auditing Services:** U.S. providers of accounting and auditing services face regulatory and market access barriers in Japan. Only Certified Public Accountants (CPAs) or Audit Corporations (made up of five or more Japanese CPAs) can offer accounting services. Foreigners must pass a national examination to qualify and this examination is offered annually. The U.S. Government will continue to urge Japan to remove restrictions on accounting services.

**Medical Services:** Restrictive regulation limits foreign access to the medical services market. The U.S. Government has recommended in the bilateral Regulatory Reform Initiative that Japan allow commercial entities to provide full service, for-profit hospitals in Japan's special economic zones as a first step to opening this sector to foreign capital affiliated providers.

**Educational Services:** Excessive regulation has discouraged foreign universities from operating branch campuses in Japan, presenting obstacles related to both administrative requirements and restrictions on pedagogical choices. Under the United States-Japan Investment Initiative, the Japanese government established a new category of "Foreign University - Japan Campus" for foreign accredited institutions of higher education. This designation provides these campuses with benefits similar to those accorded Japanese educational institutions (e.g., student eligibility for student rail passes and student visas), but does not confer tax benefits enjoyed by Japanese institutions and their students. The U.S. Government continues to urge Japan's Ministry of Education, Culture, Sports, Science and Technology to work with these foreign universities to find a nationwide solution that grants tax benefits comparable to Japanese schools and allows them to continue to provide their unique contributions to Japan's educational environment.

#### INVESTMENT BARRIERS

Despite being the world's second-largest economy, Japan continues to have the lowest inward foreign direct investment (FDI) as a proportion of total output of any major OECD country. Inward foreign mergers and acquisitions (M&A) activity, which accounts for up to 80 percent of FDI in other OECD countries, also lags in Japan, even though it is on an upward trend.

The Japanese government has recognized the importance of FDI to revitalizing the country's economy. In September 2006, the Japanese government set a goal of doubling the stock of FDI in Japan by 2010 to the equivalent of 5 percent of Gross Domestic Product (GDP). Japan has also taken several recent steps to improve the FDI environment, including revision of the Corporate Code to permit the use of triangular stock swaps for international M&A deals. However, with only one cross-border stock transaction occurring under the new rules as of October 2007, the long term effect of the liberalization of M&A rules remains unclear.

Cross-border M&A is more difficult in Japan than in other countries, partly because of attitudes toward outside investors and partly because of differing management techniques and the relative lack of financial transparency and disclosure. There is also growing concern among foreign investors about the effect of recent court rulings related to allowable defensive measures by listed companies against unsolicited takeover bids.

The United States-Japan Investment Initiative, initiated in 2001 and co-chaired by the U.S. Department of State and Japan's Ministry of Economy, Trade and Industry (METI), has worked to promote policy changes that improve the overall environment for foreign (and domestic) investment and to focus on specific barriers in certain sectors, including educational and medical services.

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#### Anticompetitive Practices

**Law against Unjustified Premiums and Misleading Representations:** Despite nominal changes to the Law against Unjustified Premiums and Misleading Representations over the past two decades, the law itself

and the Japan Fair Trade Committee's (JFTC) enforcement of its provisions block many common sales techniques such as product giveaways and lotteries. In March 2007, however, the JFTC did revise the maximum amount that a business may offer as a non-prize premium from one-tenth to two-tenths of the purchase price. Nevertheless, fair trade councils (essentially, private trade associations) set their promotion standards through self-imposed fair competition codes that are recognized by the JFTC. These codes frequently impose additional standards that effectively protect vested manufacturing and retailing interests to the detriment of new entrants to the market. As of November 2007, there were still 38 JFTC authorized premium codes.

(For detailed discussion on other anticompetitive practices and Antimonopoly Act enforcement, see the section above titled "Structural Regulatory Reform.")

#### OTHER BARRIERS

##### Autos and Automotive Parts

A variety of nontariff barriers have long impeded access to the autos and automotive parts market and overall sales of North American made vehicles and parts in Japan remain low. Even as U.S. automakers have invested in Japanese automobile manufacturers, there has not been a corresponding level of increase in sales in Japan's market. The Japan Automobile Importers Association (JAIA) reports that sales of U.S. produced motor vehicles in Japan decreased in 2006 to 16,290 units.

Through the Regulatory Reform Initiative, the U.S. Government continues to address crosscutting structural and regulatory reform issues with Japan that affect the automotive sector, including urging Japan to take steps that help expand the opportunities for foreign investment, strengthen competition policy, and increase transparency in rule making.

##### Aerospace

Japan is among the largest foreign markets for U.S. civil aerospace products. The civil aerospace market in Japan is generally open to foreign firms and some Japanese firms have entered into long-term relationships with American aerospace firms. The U.S. Government continues to monitor Japan's development of indigenous civil aircraft.

Military procurement by the Ministry of Defense (MOD) accounts for over half of the domestic production of aircraft and aircraft parts and continues to offer the largest source of demand in the aircraft industry. Although U.S. firms have frequently won contracts to supply defense equipment to Japan (over 90 percent of the annual foreign defense procurement is from the United States), the MOD has a general preference for domestic production or the licensing of U.S. technology for production in Japan to support the domestic defense industry.

Although Japan has considered its main space launch vehicle programs as indigenous for many years, U.S. firms continue to participate actively in those space systems, including Japan's primary space launch vehicle, the HII-A. The U.S. Government has welcomed Japan's plans to develop a supplementary GPS navigation satellite constellation known as the "quasi-zenith" system. The U.S. Government is working closely at the technical level with Japanese counterparts to ensure the Japanese and U.S. systems remain compatible and anticipates U.S. companies will have the opportunity to supply major components.

##### Business Aviation

Japan's regulatory framework coupled with infrastructure shortages impedes the development of business aviation in Japan. Due to the lack of business aviation-specific guidelines, regulations for commercial airline safety, maintenance, and repair issues administered by the Japan Civil Aviation Bureau (JCAB) of the Ministry of Land, Infrastructure, Transport and Tourism (MLIT) also apply to business aircraft. This situation in turn raises the costs of qualification, operation, and maintenance of business aircraft to uneconomical levels. As a result, most business aircraft in Japan

are registered in the United States.

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Landing rights for business aircraft in Japan are also difficult to obtain due to rules that hamper flexible scheduling, especially in the Tokyo area. The current regulatory environment, furthermore, frustrates Japanese companies, foreign companies in Japan, and foreign companies interested in doing business with Japan. U.S. aircraft manufacturers also express concern that the regulatory situation has greatly limited sales of their airplanes to potential Japanese clients.

Recognizing the potential of business aviation in Japan (and hoping to compensate for the absence or insufficient number of scheduled commercial routes), certain airports in the Chubu and Kansai regions have begun to attract business aircraft, although results thus far are modest. Regional airports are attempting to provide many of the same services business aircraft operators receive in the United States and Europe. However, severely restricted hours for landings and take-offs at Japan's preferred business destination - Haneda Airport in Tokyo - and the lack of services at both Narita and Haneda, continue to significantly limit travel to and within Japan.

Based on the growing needs of business aircraft owners and operators, the U.S. Government has continued urging JCAB to reexamine the application of airline-specific civil aviation regulations to business aviation and develop appropriate regulations specific to the business aviation industry. These regulations should, to the greatest degree possible, reflect a regulatory approach consistent with the treatment of business aviation in North America, Europe, and other developed world economies. The U.S. Government urges Japan to make immediate improvements in the overall regulatory framework for business aviation in advance of the opening of an additional runway at Haneda planned for 2010.

In the past year, JCAB has taken some initial and positive steps to address these concerns, including regular participation in business aviation events in the United States and Japan, frequent dialogues with the U.S. Government, the industry, and U.S. and Japanese business aviation associations, and taking preliminary positions aimed at deregulation. The JCAB released a report on business aviation in May 2008, which concluded the use of business jets in Japan constitutes an important part of Japan's aviation future and that the country lags noticeably behind other countries in the development of business aviation.

The JCAB recently laid out a road map for a new policy entitled, "The Four 'F's to Develop Japan's Business Aviation Tomorrow." The "Four F's" call for improvements in facilitation, (regulatory) framework, facilities, and fields (in the Tokyo area). In July 2008, in its first actual deregulation involving business aviation, JCAB extended its ETOPS (Extended-range Twin-engine Operational Performance Standard) requirement from 60 minutes to 180 minutes. This means that JA (Japan) registered aircraft with two engines are now permitted to fly routes far longer than they could previously. As a result, greater market opportunities are now open for business jets with sufficient range.

#### Civil Aviation

Consistent with its longstanding policy to promote competition and market access in civil aviation, the U.S. Government continues to press Japan for further liberalization.

Market access for U.S. air carriers in Japan improved significantly with a 1998 bilateral agreement and additionally with a new bilateral agreement reached in September 2007 (pursuant to comity and reciprocity pending formal conclusion). U.S. carriers, however, remain constrained by restrictions on traffic rights, operational flexibility, change-of-gauge, and pricing. Other key concerns include the continuing disparity between the rights of "incumbent" and "non-incumbent" airlines, and some of the world's highest airport costs.

The September 2007 agreement provides non-incumbent cargo carriers

the ability to serve additional points in Japan and beyond. It also removes most restrictions and limitations on same country code-sharing arrangements, but these remain more limited than the open code-sharing framework in U.S. agreements with most other countries. The agreement also relaxed the pricing regime from "double approval" to "country of origin." It fell short, however, of the standard "double disapproval" regime for pricing liberalization. U.S. industry has expressed concern that Japan requires cumbersome and time-consuming filings for fare changes.

Tokyo's Narita International Airport operates below its potential capacity. The U.S. Government continues to encourage Japan to take steps to increase capacity and reduce congestion at one of the world's most important airports. An extension of Narita's second

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runway that will facilitate more long haul flights is currently underway, although concerns remain about the project's financing -- specifically that already high user fees might be increased. Recently lowered landing fees at Narita were offset in part by the imposition of other new or increased fees. The U.S. Government continues to raise the issue of high landing fees at Narita, Kansai, and Central Japan International Airport (Centrair) airports in the Regulatory Reform Initiative and other bilateral discussions.

Both Narita and Haneda Airports are undergoing ambitious expansion projects set to be completed by 2010. However, the planning process for both these projects has not been fully transparent. The U.S. Government has raised with Japan concerns about how new slots at Narita Airport will be allocated, and prospective rules at Haneda that could adversely affect the competitiveness of U.S. carrier operations in the long term. The U.S. Government urges Japan to ensure that, through a timely and transparent consultative process, non-Japanese carriers have meaningful opportunities to comment. Connections between airports in the Tokyo metropolitan area remain difficult and time-consuming. The weak connectivity undermines the efficiency of the airports and carriers serving Tokyo. The U.S. Government encourages Japan to improve transit access between Haneda and Narita Airports.

#### Transport/Ports

The U.S. Government continues to raise longstanding concerns about barriers to entry to, and the competitiveness of, Japanese ports. Foreign shippers servicing Japan are locked into long-term relationships with specific Japanese stevedoring companies, which reportedly collude within the industry association to keep newcomers out and costs high. Foreign companies are concerned that a lack of transparency in Japanese laws and regulations related to ports creates a barrier to entry. Foreign owned and run stevedoring businesses do not exist at major Japanese ports, and even major Japanese companies have been prevented from directly involvement in the stevedoring business. As part of the Regulatory Reform Initiative, the U.S. Government has made recommendations on transparency that are applicable to the rulemaking process. Japanese laws and regulations could be reviewed with an eye to facilitating new entrants and outside competition in the stevedoring business.

Japan amended its Port Transportation Business Law (effective November 2000) to eliminate the need for new entrants to prove the existence of surplus demand. Charges for harbor services in nine large ports are subject to a prior notification requirement, and there is an approval requirement for other ports by the MLIT.

Since 1999, the U.S. Government has continued to express concern that reforms have not lessened the Japan Harbor Transportation Association (JHTA)'s ability to deter new entry and restructuring in the ports sector. The Port Transportation Business Law introduced requirements that run counter to the need for efficient port operations and discriminate against new entrants wishing to offer port services. In addition, MLIT has not addressed concerns about the prior consultation process conducted by the JHTA nor about the apparent threat of illegal strikes against foreign carriers who obtain permission to operate their own container terminals. The U.S. Government has raised with the Japanese government its failure

to implement important aspects of the wide-ranging port deregulation promised in 1997.

End text.

SCHIEFFER